

MONTEBELLO REDEVELOPMENT AGENCY

Review Report

SELECTED TRANSACTIONS

July 1, 2005, through June 30, 2010



JOHN CHIANG
California State Controller

September 2011



JOHN CHIANG
California State Controller

September 22, 2011

Art Barajas
Major of the City of Montebello
1600 West Beverly Boulevard
Montebello, CA 90640

Dear Mayor Barajas:

The State Controller's Office (SCO) reviewed selected transactions of the Montebello Redevelopment Agency (RDA) for the period July 1, 2005, through June 30, 2010. This report presents the findings and conclusions of our review of the RDA.

We concluded that the redevelopment agency failed to comply with Health and Safety Code requirements in numerous areas. Specifically, our review has identified the following issues:

Financial Findings

- The RDA incurred ineligible expenditures in Bond Proceeds Fund No. 870 from July 1, 2005, through June 30, 2010, totaling \$3,571,026.
- The RDA did not make its required annual pass-through payments to affected taxing agencies for FY 2009-10 and FY 2010-11 of \$972,435, \$1,944,870 in total.
- The RDA deferred payments into the Low and Moderate Income Housing Fund for the Montebello Hills Project Area for approximately 13 years. As a result of the deferrals, the fund balance of \$13,017,689 is understated by \$12,139,385. The balance should be approximately \$25,157,074 at June 30, 2010.
- The RDA had an excess surplus of \$12,219,124 in its Low and Moderate Income Housing Fund. Additionally, this was not noted in the RDA's independent auditor's report for the period ended June 30, 2010.
- The RDA charged the Low and Moderate Income Fund for unsupported planning and administrative costs of \$50,000 per year for FY 2005-06 through FY 2009-10, for a total of \$250,000.

- The Low and Moderate Income Housing Fund was charged \$9,423 for ineligible administrative fees.
- The RDA purchased a property (single-family home) in December 2009 out of the Low and Moderate Income Housing Fund, for \$365,000. This property was located outside of the RDA project area and the RDA did not make the required determination to spend the Low and Moderate Income Housing Funds outside of the project area.

Compliance Findings

- The RDA did not submit the FY 2009-10 Independent Auditor's Report to the SCO within six months after the end of fiscal year. The report was submitted on April 5, 2011, in excess of three months after the due date.
- The Independent Auditor's Report for FY 2009-10 was not submitted to the RDA's legislative body within six months after the end of the fiscal year as required by the Health and Safety Code section 33080.1.
- For FY 2005-06 through FY 2009-10, the Annual Reports to the Legislative Body required pursuant to the Health and Safety Code section 33080.1 did not include all the required items.
- The RDA's annual budget for FY 2009-10 did not include all the information required by Health and Safety Code section 33606.
- The RDA's Five-Year Implementation Plan for 2010 through 2014 was due on December 31, 2009, but was not finalized and approved until December 31, 2010.
- The RDA failed to comply with Health and Safety Code section 33490(c) by not performing a mid-plan review of the Five-Year Implementation Plan.
- The RDA failed to establish and maintain a housing database pursuant to Health and Safety Code section 33418(c)(1).
- The RDA's independent auditors failed to identify compliance issues including "major audit violations" and did not include all required information.

Observations

- The RDA made questionable loans to the city General Fund.
- The RDA board approved issuance of more than \$28 million in forgivable loans.
- Bank accounts were not included in the RDA's financial records.

In its response to our draft report, the city concurred with ten of the fifteen findings, and disagreed with the remaining five findings. The city disagreed with all three observations. The city generally asserted that most of the issues in dispute stemmed from differences in interpretation of law. The city's response stated "The interpretation of the law should be left to the courts. Legal experts and others versed in redevelopment operation may have different interpretations and without specific guidance from the courts, those are equally as valid as those of the State Controller's Office."

On the contrary, the disputed issues were not due to differences in subjective interpretation of laws. The basic principle governing any use of public funds is that the expenditures must be necessary, reasonable, and supported by adequate documentation. We found the city failed to adhere to this principle in many of its financial practices. All of the findings in our draft report remained unchanged with the exception to the issue relating to the purchase of Dodger tickets and parking passes described in Finding #1 of our report).

The city's responses to our findings and our comments are incorporated into the body of the report. The city's entire response is also included as an attachment to this report..

If you have any questions, please contact Steven Mar, Chief, Local Government Audits Bureau, at (916) 324-7226.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB:wm

cc: Frank Gomez, Mayor Pro Tem
City of Montebello
William M. Molinari, Councilmember
Montebello City Council
Alberto Perez, Councilmember
Montebello City Council
Christina Cortez, Councilmember
Montebello City Council
Larry Kosmont, Interim City Administrator
City of Montebello
David Biggs, Interim Assistant City Administrator
City of Montebello
Francesca Schuyler, Director of Finance
City of Montebello

Contents

Review Report

Introduction	1
Background	2
Objectives, Scope, and Methodology	4
Conclusion	4
Views of Responsible Officials.....	4
Restricted Use	5
Findings and Recommendations.....	6
Observations	33
Appendix 1—Forgivable Loans	39
Attachment—City’s Response to Draft Review Report	

Review Report

Introduction

The State Controller's Office (SCO) reviewed selected transactions of the Montebello Redevelopment Agency (RDA) for the period July 1, 2005, through June 30, 2010. On April 21, 2011, the SCO notified the Interim City Administrator, Peter Cosentini, that the City of Montebello and the Montebello Redevelopment Agency have not complied with State law regarding the submittal of annual reports and independent audits, as follows:

- City of Montebello—The Annual Report of Financial Transactions of Cities for 2009-10 as required by Government Code section 53891 was not completed.
- Montebello Redevelopment Agency—Annual Report of Financial Transactions of Redevelopment Agencies for 2009-10 as required by Health and Safety Code section 33080.1 was incomplete.
- City of Montebello—The Single Audit Report was not submitted by the due date of March 31, 2011.

Both the city and the RDA have been delinquent in providing these reports in past years. These delays in compliance have raised concerns about the reliability and accuracy of the information in the reports. This was of a particular concern in light of this and other information about the city's and RDA's financial practices. For example:

- The 2008-09 single audit of the City of Montebello identified several material or significant deficiencies in the city's internal controls over financial reporting and compliance. Several of the deficiencies had been noted in previous audits and still had not been addressed.
- The recent presentations to the City Council contained the following information:
 - Restricted funds under the control of the city have been used to pay for the city's general purpose administrative costs.
 - Reimbursement of the restricted fund loans have only been made possible by loans of \$14.8 million from funds that are supposed to be used for redevelopment programs.
 - Loans of some restricted funds can be made as long as they are paid back by the end of the fiscal year or sooner as necessary to address required expenditures of the fund or agency from which they were borrowed. However, that is not always the case.
 - The use of restricted funds and redevelopment loans are the only reason the city has avoided deficit spending in its general fund.
 - Without actions to reduce expenditures or increase revenue, the city is expected to run out of cash by October 2011. Among other things, this would mean that the city would not meet financial obligations, including paying employees.

- The city was recently made aware that two “off the books” bank accounts had been in existence for more than ten years without the knowledge of city officials. It is not clear whether they were reflected in the prior Annual Report of Financial Transactions for Cities submitted by the city.
- Council Member Christina Cortez has expressed concerns in public meetings and verbally to SCO staff about actions taken by the city in the past, particularly the loan of funds from the redevelopment agency. In addition, she raised concerns about the use of Housing and Urban Development (HUD) funding. We understand that a report from the Office of the Inspector General at HUD concludes that the city may have to pay back nearly \$1.3 million.
- The former Interim City Administrator resigned effective May 13, 2011, because the city council would not consider timely action to address the financial issues raised by the Interim City Administrator. In addition, Council Member, Frank Gomez, made a public statement that the other council members were either “in denial” or “lacked the conviction to do anything to solve the problem.”

After considering the above information, SCO concluded that there is reason to believe that the Annual Report of Financial Transactions submitted by the city and the RDA is false, incomplete, or incorrect. Therefore, under Government Code section 12464(a), the SCO conducted an investigation to gather the information needed to validate the information provided for those reports for Fiscal Year (FY) 2009-10.

In addition, the SCO will review any programs with state general funds or special funding, and/or any federal funding passed through the State to the city or the RDA by a State agency. These additional activities will be conducted under Government Code section 12468 which authorizes the State Controller to “. . . regularly audit the apportionment and allocation by counties of property tax revenue . . .” and under Government Code section 12410 which authorizes the Controller to “. . . superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment.” While the focus of the review will be on FY 2009-10, issues may arise that will necessitate a review of transactions in prior periods.

Background

The City of Montebello is located in Los Angeles County, California. As of 2007, the population was 64,695, living in an area of 8.2 square miles. On October 16, 1920, Montebello was incorporated as the 35th of the present cities in Los Angeles County. The city conducts its operations as a general law, council/administrator city.

The Montebello Redevelopment Agency (RDA) was established in May 1969. The primary purpose of the RDA is to eliminate blighted areas by encouraging development of residential, commercial, industrial, recreational, and public facilities. The RDA has established three redevelopment project areas encompassing approximately 1,615 acres.

From an accounting perspective, the RDA is a component unit of the city. However, for other purposes, the RDA is a completely independent entity. For example, the city has no responsibility to repay debt incurred by the RDA.

The general purpose of redevelopment is to eliminate “blight.” Health and Safety Code section 33020 states:

“Redevelopment” means the planning, development, replanning, redesign, clearance, reconstruction, or rehabilitation, or any combination of these . . . and the provision of those residential, commercial, industrial, public, or other structures or spaces as may be appropriate or necessary in the interest of the general welfare, including recreational and other facilities incidental or appurtenant to them.

A redevelopment agency cannot levy a tax rate. Instead, a redevelopment agency receives its funding from tax increment revenues. Tax increment revenues are revenues generated by the increase in the value of property within the redevelopment project over the value of the property when the project was established (base value). The California Supreme Court described the process as follows:

Under tax increment financing, “[a]ll taxable property within the area to be redeveloped is subject to ad valorem taxes. The properties lying within a redevelopment area have a certain assessed value as of the date a redevelopment plan is adopted. A local taxing agency, such as a city or county, continues in future years to receive property taxes on the redevelopment area properties, but may only claim the taxes allocable to the base year value. If the taxable properties within the redevelopment area increase in value after the base year, the taxes on the increment of value over and above the base year value are assigned to a special fund for the redevelopment agency.

Once the redevelopment plan is adopted, the redevelopment agency may issue bonds to raise funds for the project. As the renewal and redevelopment is completed, the property values in the redevelopment area are expected to rise. The taxes attributable to the increase in assessed value above the base year value are assigned to the redevelopment agency, which then uses the funds to retire the bonds. The local taxing agencies still receive taxes attributable to the base year assessed value of the properties within the redevelopment area. This way, the redevelopment project in effect, pays for itself.

Redevelopment agencies are subject to a number of accounting and reporting requirements as well as administrative requirements. These specific requirements are discussed in the Findings and Recommendations section of this report.

Objectives, Scope, and Methodology

The objective of the review was to ascertain the RDA's degree of compliance with administrative, financial, and reporting of Health and Safety Code requirements.

To accomplish our objectives, we performed the following procedures:

- Made inquiries of employees regarding RDA operations and reports.
- Reviewed RDA general ledger detail trial balance reports for all fiscal years.
- Selectively analyzed accounts from the above ledgers.

We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based upon our objectives.

Conclusion

We found that the Montebello Redevelopment Agency failed to comply with numerous Health and Safety Code requirements which resulted in the RDA's fund balances being understated as follows:

Bond Proceeds Fund	\$5,515,896
Low and Moderate Income Housing Fund	\$24,982,932

The reported revenues/expenditures and fund balances reported by the RDA in the Financial Transactions Reports for FY 2009-10 were incorrect and/or incomplete.

The findings and recommendations in this report should be taken into consideration when preparing the Financial Transactions Reports.

Views of Responsible Officials

We conducted an exit conference on August 4, 2011, with Larry Kosmont, Interim City Administrator; David Biggs, Assistant Interim City Administrator; Michael Huntley, Director of Community Development; and Francesca Schuyler, Director of Finance. We issued our draft report dated August 24, 2011. The RDA provided its response to our draft report on September 8, 2011, and it is included in this report as an Attachment. The RDA provided in excess of 300 pages of attachments pertaining to its response which can be obtained by contacting the RDA.

In its response, the city agreed with ten of the 15 findings and disagreed with the five remaining findings. The city also disagreed with the three observations. After carefully reviewing and analyzing the city's response, we have found no validity in any of the city's responses and thus all of the findings remained unchanged with the exception to the issue relating to the purchase of Dodger tickets and parking passes described in Finding #1 (page 15 of our report). The observations in the draft report also remain unchanged.

The city's response and the SCO's comment to each specific issue are included immediately following each issue.

Restricted Use

This report is intended for the information and use of the Montebello Redevelopment Agency, the City of Montebello, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

September 22, 2011

Findings and Recommendations

Noncompliance With Government Code Section 12464

We reviewed the Montebello Redevelopment Agency's (RDA) Financial Transactions Report for Fiscal Year (FY) 2009-10 to ascertain the RDA's degree of compliance with Health and Safety Code requirements. Additionally, we performed a review of the RDA's Independent Financial Audit Report for FY 2005-06 through FY 2009-10 for compliance with the Guidelines for Compliance Audits of California Redevelopment Agencies.

With respect to Government Code sections 12463.3 and 12464, our review determined that the RDA's Annual Report of Financial Transactions of Redevelopment Agencies and the Independent Financial Audit Report for FY 2009-10 were incomplete and incorrect based on the following:

- FINDING 1—The RDA overstated its expenditures in Bond Proceeds Fund No. 870 by \$3,571,026 and understated the fund balance by the same amount.
- FINDING 2—The RDA did not make its required pass-through payments to affected taxing agencies for FY 2009-10 in the amount of \$972,435. This failure resulted in reported assets being overstated.
- FINDING 3—The RDA failed to account for the deferral of the 20% set-aside in the Low and Moderate Income Housing Fund in its accounting records and its annual report of financial transactions. This failure resulted in the reported fund balance being understated by \$12,139,385.
- FINDING 4—The RDA failed to account for \$12,219,124 of excess surplus in its accounting records as well as in its annual report of financial transactions. As a result of this omission, the independent financial audit report and the California Department of Housing and Urban Development's Housing and Community Development report were incorrect.
- FINDING 5—The RDA overstated its Low and Moderate Income Housing Fund administrative costs by \$50,000 a year in the annual report of financial transactions and the independent auditor's report for FY 2005-06 through FY 2009-10.
- FINDING 6—The RDA charged ineligible administrative fees totaling \$9,423 to the Low and Moderate Income Housing Fund. This error resulted in the RDA's Low and Moderate Income Housing Fund administrative expenditures being overstated.
- FINDING 7—In December 2009, the RDA purchased a single-family home for \$365,000 using Low and Moderate Income Housing Funds. The property was located outside of the RDA project area. This ineligible purchase resulted in assets being overstated and the fund balance being understated by \$365,000.

Financial Findings

FINDING 1—
Ineligible costs were
charged to the Bond
Proceeds Fund.

The RDA incurred ineligible expenditures in Bond Proceeds Fund (Fund No. 870) from July 1, 2005, through June 30, 2010, totaling \$3,572,341. The ineligible expenditures, as well as the city's response and the SCO's comment, are presented in detail following the recommendation.

Recommendation

The city should reimburse \$3,572,341 to the RDA for ineligible expenditures and should establish procedures and monitor expenditures from the RDA fund to ensure that only redevelopment related activities are charged. If the city charged administrative costs, it should develop an equitable method to distribute administrative costs to the RDA as well as all benefiting departments based on actual costs and should be updated at least once every two years.

Ineligible Administrative Costs

The City of Montebello charged the RDA for ineligible administrative costs ranging from \$605,000 to \$805,000 per year, totaling \$3,425,000 as follows:

Fiscal Year					
2005-06	2006-07	2007-08	2008-09	2009-10	Total
<u>\$ 605,000</u>	<u>\$ 605,000</u>	<u>\$ 605,000</u>	<u>\$ 805,000</u>	<u>\$ 805,000</u>	<u>\$3,425,000</u>

The city did not provide any documentation to support these administrative costs charged to the RDA. Therefore, administrative cost charges for FY 2005-06 through FY 2009-10 in the amount of \$3,425,000 are unallowable.

Our review only quantifies the ineligible administrative costs for the period of July 1, 2005, through June 30, 2010. However, this practice of unsupported transfers has been in existence for at least 15 years.

City's Response

The City believes that the level of administrative overhead charges to its various funds, including Redevelopment, is supported and well within an acceptable range based on any number of cost recovery models. For redevelopment, there is no statutory or other regulatory requirements as to how administration and overhead costs are to be allocated, and absent such requirements, the determination of the Governing Board of the Agency as to appropriateness is made through the adoption of the annual budget, at the Board's sole discretion.

Additionally, it should be acknowledged, that there are no statutory or regulatory requirements to guide redevelopment agencies statewide as to the appropriate methodology or guidelines for calculating the administrative costs allocated to a redevelopment agency. This is apparent in the State Controller's report of 18 redevelopment agencies from July 1, 2009 through June 30, 2010 where a finding was made stating that there are significant differences among redevelopment agencies for accounting for planning and general administrative costs.

That being said, the City is aware that its current cost allocation study, last updated in 1992, is outdated and it is in the process of being

updated (apparently the SCO's audit team was not provided with a copy of the 1992 study, and as one has been subsequently located, a copy is attached as Exhibit C).

The City embarked on an effort to update its cost allocation model in 2010 and retained the firm of Willdan Financial Services to undertake this effort. Willdan is an acknowledged leader in this area. Willdan completed a Cost Allocation Plan for the City in October, 2010, with the City's intent at that time having been to review and implement the model for purposes of undertaking administration allocations for FY 2011/12. However, the City's burgeoning financial crisis and staff turnover resulted in this effort being delayed. The prior year's level of overhead and administration allocations were carried over to FY 2011/12. A copy of the proposed Willdan Cost Allocation Plan, not yet accepted by the City, is attached as Exhibit D for background information.

The new City management team has on a priority basis, renewed the review of the Willdan Cost Allocation Plan in order to make adjustments to the methodology proposed by Willdan. Adjustments may include capital projects, investment management, and self-insurance contribution review, to ensure a more comprehensive level of cost recovery. The City is on track to have the updated model in place for FY 2012/13.

In the interim and In order to respond directly to the concerns expressed by the State Controller's Office, the City did undertake an effort to test the historical allocations reviewed by the State Controller against the proposed Willdan Cost Allocation Plan. In this exercise, the City made preliminary adjustments to the Willdan Model to reflect all costs and a full allocation of administration departments to reflect total costs for application to redevelopment. The Willdan initial allocation and an adjusted calculation were determined and the percentage for the redevelopment funds for that control year of 2009/10 (both budgeted and actual expenditures), was applied to the prior fiscal years to allow for an indication of scale comparison. A five-year average was also illustrated for purposes of comparison.

Finally, two other measures were developed, one based on administrative allocations as percentage of revenue and one as a percentage of expenditures. This analysis is attached as Exhibit E and clearly demonstrates that administration costs allocated to redevelopment were supportable notwithstanding the lack of a regularly updated cost allocation model.

Based on the lack of statutory authority and the additional supporting documentation provided, the SCO should eliminate this finding.

SCO's Comment

The city's response failed to demonstrate that administrative charges were supported by appropriate documentation. The SCO finding is that there is no supporting documentation for the transfer and therefore it is an ineligible expenditure. There was and still is no documentation for the administrative charges. The documentation attached to the city's response as Exhibit C, D, and E was not in support of the charges and was created after the fact. In addition, the cost allocation plan (city's response, Exhibit C, FY 1990-91) does not include RDA in that plan.

The finding remains as stated.

Ineligible Goods and Services

The RDA expended funds for ineligible goods and services as follows:

The RDA expended \$73,816 for sales tax audit services for FY 2005-06 through FY 2009-10. While these audits may increase sales tax collections, there is no redevelopment purpose for these services and sales taxes generally are revenue to the city General Fund.

Annual charges for sales tax audit services were:

Fiscal Year					
2005-06	2006-07	2007-08	2008-09	2009-10	Total
\$ 28,598	\$ 7,372	\$ 12,658	\$ 2,868	\$ 22,320	\$ 73,816

City's Response

The State Controller's Office would be correct if the services were purely for evaluating and ensuring that sales tax was appropriately reported and paid to the City. However, the HdL contract has two components – sales tax reporting and sales tax auditing. Sales tax reporting is of greatest value to the Redevelopment Agency since not only are most of the City's retail sales tax producing businesses located in redevelopment project areas, but those businesses and commercial centers generate the highest sales tax such as the Shops at Montebello, Montebello Town Square, Montebello Plaza, Costco and the Chevron gas distribution facility. In addition, sales tax levels are a key indicator of economic health, and sales tax data is one of the key performance indicators for redevelopment activities as well as return on investment metrics for specific redevelopment projects. Accordingly, payment by the Redevelopment Agency for sales tax reporting services by HdL is completely appropriate and necessary. The City will undertake a further review of the amounts paid to HdL for any sales tax, auditing costs and these will be reallocated to the City's General Fund.

The SCO should eliminate this finding as to sales tax reporting services.

SCO's Comment:

The city's response provides no additional information or evidence to demonstrate that the charges for the services were necessary and were adequately documented.

The finding remains as stated.

Ineligible Promotional Items

The RDA expended \$50,055 for ineligible promotional items from FY 2005-06 through FY 2009-10. These items generally have the city's name and the Economic Development Department's phone number displayed on the items. Though these items may promote the city and the Economic Development Department, they do not perform nor promote any redevelopment related functions.

Fiscal Year					Total
2005-06	2006-07	2007-08	2008-09	2009-10	
\$ 7,284	\$ 11,039	\$ 8,266	\$ 13,814	\$ 9,652	\$ 50,055

City's Response

The State Controller's Office would be correct if the intended purpose was to promote the City apart from its redevelopment and economic development components. These promotional items are acquired specifically for the purpose of promoting the City as a place for redevelopment and investment.

The majority of the City's retail areas are located in redevelopment project areas and all of the promotional items identified in the draft finding were purchased specifically for the Redevelopment Agency's retail recruitment and attraction efforts at the International Council of Shopping Centers conference in Las Vegas. The ICSC Conference is the primary outlet for cities to exhibit various retail investment opportunities, which such opportunities are not competitive unless promoted in conjunction with the prospect of redevelopment financing support, particularly in urban areas in California such as Montebello, wherein absent redevelopment funding assistance, land values exceed pro forma pricing benchmarks for most retailers and restaurants.

Since this is a national conference, it is important to identify where Montebello is located since many of the attendees are from all over the United States. Attendees are more likely to identify with the name of the City than the Redevelopment Agency. By the State auditors deciding that because the City's name and Economic Development Division's phone number (whose staff members are Redevelopment Agency staff) are the only information identified on the promotional items does not promote redevelopment is insufficient to make a determination of its validity. The national event that the promotional items were purchased for is fully staffed by Redevelopment staff and Agency members promoting opportunities. Understanding the location of the City is one of the keys to success. Further, efforts to recruit private investment at this conference are enhanced significantly due to the tools provided by the redevelopment agency within the project areas. Redevelopment financing is a significant basis for the multiple economic development based meetings at this and other conferences that the Staff attends.

The SCO should eliminate this finding.

SCO's Comment

The city's response provide no additional information or evidence to support the city's claims that approximately \$50,000 in promotional items is necessary and reasonable. The items at best promoted the city, not the city as a place where redevelopment may provide financial assistance. The finding remains as stated.

Ineligible Expenditures Relating to Independent Cities Association

The RDA expended \$20,767 for ineligible expenditures relating to the Independent Cities Association conferences from FY 2005-06 through FY 2009-10. Ineligible expenditures related to these conferences include golf, registration fees, and travel for city employees. These conferences were held to promote general city tourism and were not related to redevelopment activities.

Fiscal Year					Total
2005-06	2006-07	2007-08	2008-09	2009-10	
\$ 4,556	\$ 4,068	\$ 4,665	\$ 3,395	\$ 4,083	\$ 20,767

City's Response

The State Controller's Office would be correct if the intended purpose of the Independent Cities Association and conferences was to promote general City tourism. However, the ICA is an association of cities which provide a full range of services including police and fire services. The topics covered at their meetings often include redevelopment, economic development and general governance issues such as AB 1234 and managing elements of any public entities, including evaluating positions such as the City Administrator/Redevelopment Executive Director. As such, membership and participation in ICA provide direct benefit to the Redevelopment Agency and those Redevelopment Agency Board members who participate and use of redevelopment funds in support of this is appropriate. Historically, only half of the costs to attend these events have been charged to the Redevelopment Agency with the balance being paid from the City's General Fund.

The SCO's one cited example of where the Redevelopment Agency paid 100% of a single expense as part of an ICA event was in fact fully refunded since the Council Member/Agency Board Member who was to attend had cancelled. If the Council Member/Agency Board Member had attended, it is likely the final reconciliation of the total expenses for the event would have been reconciled and the normal 50%/50% allocation would have been applied.

The SCO should eliminate this finding.

SCO's Comment

The city's response provide no additional information or evidence to demonstrate charges, such as a council member's golf game at an ICA conference, were necessary and reasonable. The city's assertion that 50% of ICA expenditures are allocated to the RDA was not supported with any documentation during the review or in its response. Furthermore, the 50% allocation appears to be an arbitrary numbers and not supported by any documentation as to how it was determined.

The finding remains as stated.

Inappropriate Use of RDA Funds by a City Manager

In May 2009, a city manager incurred expenditures of \$1,315 of RDA funds for the purchase of Dodgers tickets and parking passes, and \$788 for dinner in Las Vegas. The same city manager also received per-diem reimbursement for the dinner in Las Vegas. This city manager also incurred \$3,112 in petty cash reimbursements from the RDA during July and September 2009, of which approximately \$600 was for lunches. It should be noted that the city manager approved all of these expenditures.

City's Response

The State Controller's Office is mistaken in their assertion that expenses for the City Employee's Day at the Dodgers were charged to the Redevelopment Agency as they were charged to the City's General Fund and supporting documentation is provided as Exhibit F. Also important to note is that a majority of the costs associated with Dodger's Day was reimbursed by employees. Expenses related to a dinner in Las Vegas was a legitimate business expense and appropriately charged to the Redevelopment Agency given the singular purpose for the trip was to promote retail attraction and recruitment with the most significant retail areas in the City located in redevelopment project areas. The City's adopted travel policy provides for a per diem, or average anticipated level of daily expense, based on an array of travel costs including meals, dry cleaning and other incidentals, which an employee may occur while travelling on business. There is no requirement under the City's travel policy, copy attached as Exhibit G, that a per-diem be offset in those instances where a meal might be reimbursed directly, just as there is no requirement for the City to reimburse an employee in those instances when a per diem does not cover actual expenses. Petty cash reimbursements for lunches were appropriately documented and only 50% of these lunches were charged to redevelopment. The purpose of these lunches was for the City Administrator/ Redevelopment Agency Executive Director to review upcoming items on the City Council/ Redevelopment Agency agenda. Redevelopment Agency items tend to be more complicated and take up a considerable portion of the overall time devoted to City business in Council meetings. To the extent that the State Controller's Office was concerned that some of these reimbursements were self-approved by the City Administrator/Executive Director, the City will ensure that all future reimbursements requests by the City Administrator/ Executive Director are approved by the City's Director of Finance; however, such a concern is purely perception on the SCO's part and does not change the character of the expenses.

The SCO should eliminate this finding.

SCO's Comment

The documentation provided by the agency during our review indicated that the Dodger tickets were charged to the redevelopment agency. Additional documentation provided by the agency after the issuance of our "Draft" report supported the agency's claim that these costs were paid from the general fund. However, using general fund money for Dodger tickets does not appear to be an appropriate use of public funds.

The city claims that the \$788 dinner in Las Vegas was a legitimate business expense and there should be no offset to the per diem. A per diem rate is usually established to provide a maximum rate of reimbursement and to eliminate the necessity of providing detail support for the expenses. As stated in the city's response, the per diem rate includes an allowance for meals. The city might be wise to review their travel policy to eliminate duplicate payment for the same cost.

The City claims that the self approved lunches were charged 50% General Fund and 50% RDA and was a legitimate business expense to discuss "upcoming items on the City Council/Redevelopment Agency agenda". The SCO finds it hard to believe that the City Administrator met with an official from another city at a pizza parlor known to be child friendly to discuss Montebello City Council or Redevelopment Agency agenda items. Further, the SCO was not provided this documentation to support 50% RDA and 50% General Fund claim during the review nor in the response and the City has agreed in the future to have such items approved by a third party.

The finding remains as stated.

FINDING 2—
The RDA did not make statutory pass-through payments.

The RDA did not make its required annual pass-through payments to affected taxing agencies for FY 2009-10 and FY 2010-11 of \$972,435, \$1,944,870 in total. Non-payment of these pass-through funds by the city has resulted in the State of California backfilling approximately \$510,000 from its general fund.

The RDA amended its three projects to eliminate the time limit on the establishment of debt. When a redevelopment agency amends its projects to eliminate the time limit on the establishment of debt, the Health and Safety Code requires the agency to make specified payments to affected taxing agencies if prior agreements do not exist.

Health and Safety Code section 33607.7(a) states:

This section shall apply to a redevelopment plan amendment for any redevelopment plans adopted prior to January 1, 1994, that increases the limitation on the number of dollars to be allocated to the redevelopment agency or that increases, or eliminates pursuant to paragraph (1) of subdivision (e) of Section 33333.6, the time limit on the establishing of loans, advances, and indebtedness established pursuant to paragraphs (1) and (2) of subdivision (a) of Section 33333.6, as those paragraphs read on December 31, 2001, or that lengthens the period during which the redevelopment plan is effective if the redevelopment plan being amended contains the provisions required by subdivision (b) of Section 33670. . . .

Recommendation

The RDA should develop a plan to ensure it makes its statutory pass-through payments. The RDA should also make the necessary adjustments by recording this as a liability to its accounting records to account for the pass-through payments and ensure that future reports are complete and correct (financial transactions and independent auditor's reports).

City's Response

The State Controller's Office is correct in that amending the redevelopment plans for two project areas to eliminate the limit on the establishment of debt would establish pass through obligations. However, while the Health and Safety Code does place this obligation on the Agency, it does not specify when the payments to the taxing entities are to be made.

It is possible that due to cash flow considerations an agency would be unable to make its required payments, especially in light of State raids on redevelopment coffers in recent years. Therefore, failure to make the required payments should not be a finding. While that is unfortunate for the cash flow of the State, the legislature has had numerous opportunities to establish a fixed payment date but has never done so. The Redevelopment Agency will make the FY 2011/12 pass through payments and will develop a payment schedule for the prior two years as part of its implementation of AB1 27X and has evaluated the impact on its cash flow.

The SCO should eliminate this finding.

SCO's Comment

The city acknowledged that it did not make the pass-through payments but stated that the Health and Safety Code does not specify when the payments to taxing entities are to be made. The city asserts that this should not be a finding since the RDA is having a cash flow problem and thus cannot afford to make the payment at this time.

The RDA's cash flow problems stemmed from the city's practice of using RDA funds in the form of long-term loans to fund the costs of the city's general operations. Had the RDA not let the city offset the approximately \$13 million for the next 15 years, there would be ample funds for the city to make its required payments. As noted in the observation section of this report, the members of the City Council also serve as RDA board members.

The finding remains as stated.

FINDING 3—
The Low and Moderate Income Housing Fund balance was materially understated due to deferral of payments.

The RDA deferred payments into the Low and Moderate Income Housing Fund for the Montebello Hills Project Area for approximately 13 years (1986 through 1999). The deferral amount totaled \$12,139,385, consisting of \$6,252,982 in principal and \$5,886,403 in interest. This receivable (an asset) was not recorded on the RDA's general ledgers. The audited fund balance for the Low and Moderate Income Housing Fund, as of June 30, 2010, was \$13,017,689. As a result of the deferrals noted above, the fund balance is understated by \$12,139,385 and the total fund balance should be \$25,157,074.

The RDA did establish a deferral repayment plan for the Project Area and amended the repayment plan in January 2009 by CRA Resolution No. 09-03. However, this was not recorded or accounted for in the RDA's financial records (general ledgers). The repayment plan establishes annual payments of \$75,000 through 2020 and \$700,000 from 2021 through 2028. Therefore, the Low and Moderate Income Fund will only receive approximately \$750,000 within the first ten years and the remaining \$5.5 million in the last eight years. This repayment plan does not include interest.

Health and Safety Code section 33334.6(g) states:

If, pursuant to subdivision (d) or (e), the agency deposits less than 20 percent of the taxes allocated to the agency pursuant to Section 33670 in the 1985-86 fiscal year or any subsequent fiscal year in the Low and Moderate Income Housing Fund, the amount equal to the difference between 20 percent of the taxes allocated to the agency pursuant to Section 33670 for each affected project and the amount deposited that year shall constitute a deficit of the project. The agency shall adopt a plan to eliminate the deficit in subsequent years as determined by the agency.

Health and Safety Code section 33334.2(j)(1)(C) states:

An agency found to have deposited less into the Low and Moderate Income Housing Fund than mandated by Section 33334.3 or to have spent money from the Low and Moderate Income Housing Fund for purposes other than increasing, improving, and preserving the community's supply of low- and moderate-income housing, as mandated, by this section or Section 33334.6 shall repay the funds with interest. . . .

Recommendation

The RDA should account for and record all deferrals on the agency's general ledger and calculate interest using an equitable interest rate.

The RDA should ensure that Financial Transactions Reports as well as independent financial audit reports include all related deferral and interest.

City's Response

The Agency acknowledges that it has a deferral in its Low and Moderate Income Housing fund with an Agency Board approved repayment plan and the State Controller's Office does not indicate that it is not valid. Therefore, quoting Section 33334.6 (g) and citing the repayment years is inappropriate since noncompliance in establishing the deferral or its repayment is simply not present. The SCO commentary gives an uninformed reader the impression that something is wrong when it is not and should be removed. Since the Health and Safety Code does not specify the type of repayment plan or its specific provisions including any requirement for interest to be paid, the comment of the SCO restating the years and amounts to provide for interest due appear to be provided only for editorial reasons and should be eliminated as it imparts noncompliance to an uninformed reader. In 2002, the Redevelopment Agency adopted a repayment plan, which was updated in 2009, for repayment of the deferral without interest. The Agency Board's determination is all that is required under the Health and Safety Code.

It appears that the State Controller is indicating that this valid deferral "was not recorded on the RDA's general ledgers" and that has resulted in the difference noted in total assets and fund equity. However, nowhere in this finding has the State Controller's Office indicated that there is a requirement in the Generally Accepted Accounting Principle (GAAP) to record, in an agency's financial records, such a deferral. This approach to recording deferrals was considered by an authoritative committee of the California Society of Certified Public Accountants many years ago; but since, the process to record a deferral would artificially inflate fund equity, for assets which are not currently available, and a requirement to record a deferral was not instituted. Instead, it was left at the discretion of the agency and its auditors.

The Controller's citation of 3334.2(j)(1)(C) of the Health and Safety Code relating to interest potentially due the Housing Fund is correct as far as it goes; however, that is not a complete quotation of that section and is not applicable to a valid deferral. The prior two subsections (A) and (B) begin with "An action to compel compliance with the requirement of this section..." The remainder of that section which was not quoted by the State Controller is "...shall repay the funds with interest in one lump sum pursuant to Section 970.4 or 970.5 of the Government Code or may do either of the following:

- i. Petition the court under Section 970.6 for repayment in installments.
- ii. Repay the portion of the judgment due to the Low and Moderate Income

Housing Fund in equal installments over a period of five years following the judgment."

In looking at the complete section, we see terminology "action to compel," "petition the court," and "judgment" which gives the impression that this section relates to actions by courts to compel compliance for non-payment and not an additional requirement established for a valid deferral of the Housing Set-Aside.

In addition, the deferral of the 20% housing set-aside in the early years of the redevelopment project area allowed these funds to be invested into the redevelopment program in the Montebello Hills Redevelopment Project area. Throughout the 1990's there was major commercial investment in the Montebello Hills Redevelopment Project area which resulted in the development of the Montebello Town Square a sub-regional shopping center, the Costco store and the fourth major anchor' department store (Macy's) at the Shops at Montebello a regional indoor shopping center. This deferral effectively jump started the redevelopment effort with a resultant increase in tax increment revenues at a level which would not have occurred without the deferral. As such, the Low and Moderate Housing Fund is now benefitting from significant annual contributions from this project area which would not have occurred without the deferral.

The SCO should eliminate this finding.

SCO's Comment

First, the city states the Agency acknowledges that there is a deferral and that GAAP does not require the deferral to be recorded in the financial statements. The SCO noted that the deferral was not in the agency's general ledgers or financial statements and statutes state that a deferral is a liability of the agency. The City/Agency staff including City Administrator/Executive Director, Director of Finance, and Director of Economic Development was unaware of the deferral until the SCO raised the issues and provided staff with the documentation and resolutions. Furthermore, this deferral was never reported to the State Department of Housing and Community Development (HCD). Furthermore, the city notes that a repayment plan was adopted in 2002, and updated in 2009. We noted that the city updated the repayment plan after apparently not adhering to the 2002 repayment plan.

Second, the city has an issue with the SCO calculating interest on the deferral. As noted the city/agency response to Finding 4, HUD has statutory authority for many housing issues and HCD's previous audits required repayment of deferrals with interest.

The finding remains as stated.

FINDING 4—
The Low and Moderate
Income Housing Fund had
an excess surplus.

The RDA had an excess surplus totaling \$12,219,124 in the RDA's Low and Moderate Income Housing Fund (Fund No. 874). This was not reported in the RDA's annual report of financial transactions or the independent auditor's report for the period ending June 30, 2010.

Health and Safety Code section 33334.12(g) defines excess surplus in an RDA's Low and Moderate Income Housing Fund as any unexpended and unencumbered amount in the fund that exceeds the greater of \$1,000,000, or the aggregate amount deposited into the fund pursuant to specified statutes during the RDA's preceding four fiscal years.

Health and Safety Code section 33334.12(a)(1) states:

Upon failure of the agency to expend or encumber excess surplus in the Low and Moderate Income Housing Fund within one year from the date the moneys become excess surplus, as defined in paragraph (1) of subdivision (g), the agency shall do either of the following:

(A) Disburse voluntarily its excess surplus to the county housing authority or to another public agency exercising housing development powers within the territorial jurisdiction of the agency in accordance with subdivision (b).

(B) Expend or encumber its excess surplus within two additional years.

(2) If an agency, after three years has elapsed from the date that the moneys become excess surplus, has not expended or encumbered its excess surplus, the agency shall be subject to sanctions pursuant to subdivision (e), until the agency has expended or encumbered its excess surplus plus an additional amount, equal to 50 percent of the amount of the excess surplus that remains at the end of the three-year period. The additional expenditure shall not be from the agency's Low and Moderate Income Housing Fund, but shall be used in a manner that meets all requirements for expenditures from that fund.

RDAs are required to expend or encumber any excess surplus within two years of the date the funds become excess surplus. If the RDA does not expend or encumber the excess surplus, it shall disburse the money to the county housing authority or other public agency exercising housing development powers within the territorial jurisdiction of the agency.

Recommendation

The RDA should develop a plan to ensure that it expends or encumbers any excess surplus funds within three years. Additionally, the RDA should do the same in future years upon determination that funds are excess surplus.

Also, the RDA should ensure that future Financial Transactions Reports as well as independent financial audit reports include all excess surplus determinations and amounts.

City's Response

Section 33334.12(a)(2) which was cited by the State Controller's Office gives agencies three years to either expend or encumber amounts determined to be Excess/Surplus before sanctions would apply not two

years as indicated in the finding. Additionally, no disclosure would be required until three years has expired; as such sanctions are not applicable against an agency.

As to the amount cited for the potential Excess/Surplus, it was stated at \$12,219,124 with no supporting computation provided. At the request of the Agency, the State Controller's Office provided this computation. The Agency had this reviewed independently by Mr. Donald L. Parker, CPA, of Redevelopment Reporting Solutions, the foremost expert in the State on redevelopment reporting. Mr. Parker prepared an independent calculation which is attached as Exhibit H to this response. In this calculation he utilized the State Controller's computed balance for the Low and Moderate Income Housing Fund for illustrative purposes only which shows the largest possible balance for the fund; however, as discussed previously that amount is not correct as recordation of the deferral is not required by GAAP. Even with this distorted amount, as of July 1, 2009, no Excess/Surplus exists for the Agency. The same conclusion was reached by the Agency's independent auditor in the Agency's 2009/10 audit.

Mr. Parker's computation differs from the State Controller's Office because the SCO did not remove unavailable amounts and amounts exempted by the Health and Safety Code from the amount subject to limitation. As to removing unavailable amounts, the deferral discussed under Finding 3 was added by the State Controller's Office in the amount of \$12,139,385. Since this amount is unavailable presently, covered by a long-term valid repayment plan to the Low and Moderate Housing Fund, it should not be part of the amount subject to the Code limitations. The only established approach and format for calculating Low and Moderate Income Housing Excess/Surplus has been the format and approach established by the State Department of Housing and Community Development (HCD) in their reporting forms.

Since the HCD approach is one of subjecting only available resources to the prescribed limitation of the Code that approach should be followed by the State Controller's Office. As to specifically exempted amounts, the State Controller's Office did not exempt amounts present in the Senior Housing Capital Project Fund. These funds represent remaining debt proceeds relating to a senior housing project. Utilizing that determination, under Section 3334.12 (g)(3)(B) of the Code, debt proceeds are specifically exempted from the calculation of Excess/Surplus.

The SCO should eliminate this finding.

SCO's Comment

The city believes that the SCO took the largest possible balance for calculating the excess surplus. The city's expert recalculated the excess surplus without the deferral discussed in Finding 3. It should be noted that, on his calculation of the excess surplus, he cited the Health and Safety Code when eliminating the approximately \$160,000 in senior housing moneys, but, for the \$12.1 million deferral, he made no citation of the Health and Safety Code. This appears to be a case of selective Code citation.

The finding remains as stated.

FINDING 5—
The RDA charged ineligible administrative costs to the Low and Moderate Income Housing Fund (Fund No. 874)

The City of Montebello charged the RDA's Low and Moderate Income Housing Fund for ineligible administrative costs totaling \$250,000 as follows:

Fiscal Year					Total
2005-06	2006-07	2007-08	2008-09	2009-10	
\$ 50,000	\$ 50,000	\$ 50,000	\$ 50,000	\$ 50,000	\$ 250,000

The city did not provide any documentation to support administrative costs charged to the Low and Moderate Income Housing Fund. Therefore, administrative cost charges for FY 2005-06 through FY 2009-10, in the amount of \$250,000, are unallowable.

Our review only quantifies the ineligible administrative costs for the period of July 1, 2005, through June 30, 2010. However, this practice of unsupported transfers has been in existence for at least 15 years.

Recommendation

The city should reimburse the RDA's Low and Moderate Income Housing Fund \$250,000 for ineligible administrative costs charged in FY 2005-06 through FY 2009-10. Additionally, the city should develop an equitable method to distribute administrative costs to the RDA's Low and Moderate Income Housing Fund. This method should be based on actual costs.

City's Response

See the discussion under Finding 1– Ineligible Administrative Costs. The City's administrative allocation to the Low and Moderate Income Housing Fund can be supported and will be further refined during the update the City's Cost Allocation Model.

The SCO should eliminate this finding.

SCO's Comment

The city refers to its response in Finding 1; see our comment to Finding 1.

The finding remains as stated.

FINDING 6—

The RDA charged ineligible administrative fees to the Low and Moderate Income Housing Fund.

The RDA charged ineligible administrative fees totaling \$9,423 to the Low and Moderate Income Housing Fund for the series 2004a hotel project bonds. The bond proceeds for the 2004a hotel project bonds were not intended for, nor were any of the proceeds deposited, into the Low and Moderate Income Housing Fund; therefore, the fund should not pay for any costs associated with these bonds.

Health and Safety Code section 33334.2(a) states, in part:

... except as provided in subdivision (k), not less than 20 percent of all taxes that are allocated to the agency pursuant to Section 33670 shall be used by the agency for the purposes of increasing, improving, and preserving the community's supply of low- and moderate-income housing available at affordable housing cost.

Recommendation

The Low and Moderate Income Housing Fund should be reimbursed for \$9,423 in administrative fees related to the 2004a hotel project bonds. These types of bond related expenditures should be charged to the RDA Debt Service Fund.

City's Response

These charges made to the Low and Moderate Income Housing Fund appear to have been an administrative error. The \$9,423 should have been charged to funds available with the Bond Trustee and the City will make the correction and will deposit the refund of the amounts charged to the Moderate Housing Fund once received from the Bond Trustee.

The City will correct the administrative error.

SCO's Comment

The city concurs with the draft report.

FINDING 7—
The RDA purchased
ineligible property with
moneys from the Low and
Moderate Income
Housing Fund

In December 2009, the RDA purchased a single-family home for \$365,000 using moneys from the Low and Moderate Income Housing Fund. The property was located outside of the RDA project area. The RDA can only use moneys from the Low and Moderate Income Housing Fund outside its project area upon passage of a resolution from its legislative body that the use will be of benefit to the project area. The RDA did not make the required determination to spend the moneys from the Low and Moderate Income Housing Fund outside of the project area.

Health and Safety Code section 33334.2(g)(1) states:

The agency may use these funds inside or outside the project area. The agency may only use these funds outside the project area upon a resolution of the agency and the legislative body that the use will be of benefit to the project. The determination by the agency and the legislative body shall be final and conclusive as to the issue of benefit to the project area. The Legislature finds and declares that the provision of replacement housing pursuant to Section 33413 is always of benefit to a project. Unless the legislative body finds, before the redevelopment plan is adopted, that the provision of low- and moderate-income housing outside the project area will be of benefit to the project, the project area shall include property suitable for low- and moderate-income housing.

Recommendation

Moneys from the Low and Moderate Income Housing Fund should be reimbursed for \$365,000 for the ineligible property purchase. Eligible purchases outside of the project area require the RDA governing board to approve these expenditures by resolution.

City's Response

At the time the subject property was acquired, the City agrees that the required resolutions with findings were not adopted. On August 24, 2011, the City and Redevelopment Agency adopted the required resolutions and copies attached as Exhibit I.

The City has already corrected this matter.

SCO's Comment

The city concurs with the draft report.

Compliance Findings

FINDING 8—

The RDA did not submit its Independent Auditor's Report to the State Controller's Office in a timely manner.

The RDA did not submit its FY 2009-10 Independent Auditor's Report to the State Controller's Office within six months after the end of the fiscal year. The report was submitted more than three months after the due date, on April 5, 2011.

Health and Safety Code section 33080(a) states:

Every redevelopment agency shall file with the Controller within six months of the end of the agency's fiscal year a copy of the report required by Section 33080.1. In addition, each redevelopment agency shall file with the department a copy of the audit report required by subdivision (a) of section 33080.1. The reports shall be made in the time, format, and manner prescribed by the Controller after consultation with the department.

Recommendation

The RDA should establish policies and procedures to ensure timely reporting in future years, within six months after the end of fiscal year.

City's Response

The City acknowledges the annual audit for 2009/10 was not submitted in a timely manner due to the specific circumstances of that fiscal year.

The City will establish the appropriate internal controls to ensure that future audits are submitted as soon as completed.

SCO's Comment

The city concurs with the draft report.

FINDING 9—

The RDA did not submit its Independent Auditor's Report to its legislative body in a timely manner.

The RDA did not submit its Independent Auditor's Report for FY 2009-10 to the RDA's legislative body within six months after the end of fiscal year as required by Health and Safety Code section 33080.1.

Health and Safety Code section 33080.1 requires that the redevelopment agency submit the RDA's Independent Auditor's Report to its legislative body within six months of the end of its fiscal year.

Recommendation

The RDA should establish policies and procedures to ensure that the legislative body receives the Independent Auditor's Report within six months after the end of the fiscal year.

City's Response

As the Code only requires presentation and does not specify any action by the Legislative Body, documentation of this review may not have been available. The 2009/10 Redevelopment Agency audit was reviewed with the Legislative Body on April 27, 2011, as part of the a presentation of all 2009/10 audits (General Fund, Redevelopment Agency, Transit Fund, and Single Audit) by the independent auditor Eadie & Payne. The minutes for this meeting have not yet been prepared or approved, but they will reflect that the Redevelopment Audit was reviewed with the City Council. In the meantime, a copy of the Council Agenda for that date which lists the Annual Audit review under Agenda item 18 is attached (Exhibit J) as id the Eadie & Payne Presentation from April 27, 2011 (Exhibit K).

The City will establish the appropriate internal controls to ensure that Redevelopment Agency Annual Audit is submitted to the legislative body in a timely manner in the future and are appropriately reflected in the agenda and minutes.

SCO's Comment

The city concurs with the draft report.

FINDING 10—
The RDA's Annual Report to the Legislative Body was incomplete.

The Annual Report to the Legislative Body for FY 2009-10 required pursuant to the Health and Safety Code section 33080.1 did not include all required items, such as:

- The financial statement audit
- A fiscal statement for the previous fiscal year (Health and Safety Code section 33080.5).
- A description of the agency's activities in the previous fiscal year affecting housing and displacement (Health and Safety Code sections 33080.4 and 33080.7)
- A description of the agency's progress, including specific actions and expenditures, in alleviating blight in the previous fiscal year
- A list of, and status report on, all loans of \$50,000 or more, that in the previous fiscal year were in default, or not in compliance with the terms of the loan
- A description of the total number and nature of the properties that the agency owns and those properties the agency has acquired in the previous fiscal year
- A list of the fiscal years that the agency expects specified time limits of the plans to expire
- Any other information that the agency believes useful to explain its programs, including, but not limited to, the number of jobs created and lost in the previous fiscal year as a result of its activities

Recommendation

The RDA should establish policies and procedures to ensure that the Annual Report submitted to the Legislative Body is accurate and includes all required elements pursuant to the Health and Safety Code section 33080.1.

City's Response

The City believes that the components required to be in an Annual Report to the Legislative Body have been provided each year though not in a single report labeled as such.

The City will establish the appropriate internal controls to ensure the development and timely present an Annual Report to the Legislative Body in future years.

SCO's Comment

The city concurs with the draft report.

**FINDING 11—
The RDA's annual budget
is incomplete**

The RDA's FY 2009-10 budget did not include all the information required by Health and Safety Code section 33606. While the budget included revenue and expenditure data, missing were the previous year's achievements, goals for the current year, and the comparison of the achievements with the goals of the previous year's work program.

Health and Safety Code section 33606 requires a redevelopment agency to adopt an annual budget containing the following information, including all the activities to be financed by the Low and Moderate Income Housing Fund:

- The proposed expenditures of the agency
- The proposed indebtedness to be incurred by the agency
- The anticipated revenues of the agency
- The work program for the coming year, including goals
- An examination of the previous year's achievements and a comparison of the achievements with the goals of the previous year's work program

We also noted that the FY 2010-11 budget was not approved and the interim budget is lacking most of the information required by the Health and Safety Code.

Recommendation

The RDA should establish policies and procedures to ensure that the budget includes all the required elements pursuant to Health and Safety Code section 33606. The governing board should also ensure that the budget is approved in a timely manner.

City's Response

The City acknowledges that elements of required information were not included in the adopted budgets. The final budget for 2010/11 was adopted on June 15, 2011, and included the required information. The FY 2011/12 Budget adopted on June 22, 2011, included the required information. Both documents are available on-line and are attached as Exhibits L and M.

The City will establish the appropriate internal controls to ensure that all required information is included in the Annual Budget adopted in future years.

SCO's Comment

The city concurs with the draft report.

FINDING 12—
The RDA's Five-Year
Implementation Plan was
finalized and approved a
year late.

The RDA failed to comply with Health and Safety Code section 33490. The RDA's five-year implementation plan for 2010 through 2014 was due on December 31, 2009, but was not finalized and approved until December 31, 2010.

Health and Safety Code section 33490(a)(1)(A) states:

... on or before December 31, 1994, and each five years thereafter, each agency that has adopted a redevelopment plan prior to December 31, 1993, shall adopt, after a public hearing, an implementation plan that shall contain the specific goals and objectives of the agency for the project area, the specific programs, including potential projects, and estimated expenditures proposed to be made during the next five years, and an explanation of how the goals and objectives, programs, and expenditures will eliminate blight within the project area.

Recommendation

The RDA should establish policies and procedures to ensure that the Five-Year Implementation Plan is prepared and approved on time, pursuant to Health and Safety Code section 33490.

City's Response

The City acknowledges that the Five Year Implementation Plan was approved late.

The City will establish the appropriate internal controls to ensure more timely approval of the Five Year Implementation Plan in future years.

SCO's Comment

The city concurs with the draft report.

FINDING 13—

The RDA did not perform the mid-plan review of the Five-Year Implementation Plan.

The RDA failed to comply with Health and Safety Code section 33490(c) by not performing a mid-plan review of the Five-Year Implementation Plan.

Health and Safety Code section 33490(c) states:

Every agency, at least once within the five-year term of the plan, shall conduct a public hearing and hear testimony of all interested parties for the purpose of reviewing the redevelopment plan and the corresponding implementation plan for each redevelopment project within the jurisdiction and evaluating the progress of the redevelopment project. The hearing required by this subdivision shall take place no earlier than two years and no later than three years after the adoption of the implementation plan. For a project area that is within three years of the time limit on the effectiveness of the redevelopment plan established pursuant to Section 33333.2, 33333.6, 33333.7, or 33333.10, the review shall specifically address those items in paragraph (4) of subdivision (a). An agency may hold one hearing for two or more project areas if those project areas are included within the same implementation plan.

Recommendation

The RDA should establish policies and procedures to ensure that the Five-Year Implementation Plan mid-plan review is performed pursuant to Health and Safety Code section 33490(c). Additionally, RDA staff should be provided with sufficient training regarding state reporting, budgeting, and program requirements.

City's Response

The City acknowledges that the mid-plan review did not occur in a timely manner.

The City will establish the appropriate internal controls to ensure that the mid-plan review of the Five Year Implementation Plan adopted on December 31, 2010, occurs sometime between July 1, 2013, and December 31, 2013, and in a timely manner thereafter.

SCO's Comment

The city concurs with the draft report.

FINDING 14—
***The RDA did not establish
and maintain a housing
database.***

The RDA failed to establish and maintain a housing database pursuant to Health and Safety Code section 33418(c)(1). The RDA did not compile and maintain a database of existing, new, and substantially rehabilitated housing units developed or otherwise assisted with moneys from the Low and Moderate Income Housing Fund, or otherwise counted toward the requirements of subdivision (a) or (b) of section 33413.

Recommendation

The RDA should establish and maintain a housing database pursuant to Health and Safety Code section 334418(c)(1).

City's Response

The City acknowledges that a published database of Low and Moderate Income Housing has not been established and maintained.

The City will accumulate the required information regarding existing, new and substantially rehabilitated housing units, into a single published data base before June 30, 2012. The Economic Development Division is preparing a Request for Proposal to select a competent consultant to create an effective database.

SCO's Comment

The city concurs with the draft report.

FINDING 15—

The RDA's independent auditors failed to identify compliance issues including "major audit violations" and did not include all required information.

We noted noncompliance issues that the RDA's independent auditors failed to identify, such as:

- The RDA did not submit the Annual Independent Auditor's Report to the State Controller's Office and the RDA's legislative body within six months of the end of the RDA's fiscal year (Finding 8 and Finding 9).
- The RDA did not prepare a fiscal statement. Health and Safety Code section 33080.8(j)(2) defines this as a major audit violation which must be corrected (Finding 10).
- The RDA did not submit a complete budget as required (Finding 11).

In addition to the noncompliance issues noted above, the independent auditor failed to implement Statement on Auditing Standards (SAS) No. 117 on the compliance audit report.

The Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards* was prepared with a "negative assurance" with respect to compliance. AU section 801 requires compliance audits for fiscal years ending on or after June 15, 2010, to implement SAS No. 117 which requires a "positive assurance" on compliance.

Recommendation

The RDA should provide its independent auditor with a copy of our review report and discuss the findings noted. The RDA should also ensure that future audit reports identify all compliance issues such as "major audit violations" and include all information required by the Health and Safety Code.

City's Response

This finding relates to situations or information which the State Controller's Office believes should have been cited in the outside audits performed by the Certified Public Accounts serving as the Agency's independent auditors.

While the Agency engaged these auditors to perform the financial and compliance audit, the Agency is only responsible for its actions, and should not be responsible for the decisions of the independent auditors as to what to include or not include in their reports. The City has provided the information in this section to the independent Auditor and their response is attached as Exhibit N. In any event, the comments of the State Controller's Office here relating to procedures of the independent auditors are beyond the control of Agency and are in error.

The SCO should eliminate this finding.

SCO's Comment

The city contends that the actions of the independent auditors are beyond the RDA's control and thus this finding should be eliminated. It provided a response from the independent auditors to this finding.

We have reviewed the independent auditors' response to this finding and found it to be non-persuasive. The independent auditors essentially stated that they called the AICPA Technical hotline and was told that "SAS 117 only applies if the government agency requiring the audit **specifically** requires the auditor to express an opinion on compliance." This assertion ignores the fact that the Health and Safety Code requires a report on compliance, which overrides any professional guidelines.

Since it was the city that contracted with the independent auditor to perform the services, it is ultimately responsible for ensuring the works performed are in compliance with statutory requirements. For example, the city, at minimum, could direct the independent auditors to follow SAS 117 in future audits.

Observations

During our review, we noted issues relating to financial and administrative decisions by the governing board of the Montebello Community Redevelopment Agency (RDA) that raise concerns. We present these issues for consideration.

EXAMPLE 1—*The City of Montebello’s elected council members who are also the board members of the RDA agreed to make long-term loans of redevelopment assets to the City of Montebello to pay for the costs of the city’s general operations. These loans have significantly reduced the funding available to the RDA to carry out the purposes of the redevelopment program as outlined in state statutes and raise concerns about the independent decision making of the city council members when they sit as members of the RDA board.*

On July 14, 2010, the board members of the RDA agreed to loan the City of Montebello \$8 million. The terms were outlined in a non-interest-bearing promissory note (dated June 23, 2010) which indicated that the city would repay the note over a period of up to ten years. The note also indicated that the city would make quarterly payments during this period from funds the city deemed available for this purpose. Neither the promissory note nor the RDA agency resolution approving the note provided any specific authorization for this transaction.

On July 14, 2010, the members of the city council, sitting as members of the RDA board, agreed to a new non-interest-bearing loan with the city which continued the original \$8 million loan and authorized an additional loan of up to \$11.3 million (for a total of up to \$19.3 million). The provisions indicated that the intent of the city was to pay off the loan by June 11, 2011, but it also allowed the final repayment to be extended to December 22, 2011.

Section 4 of the new promissory note (dated September 22, 2010) stated that the loan was authorized under California Government Code section 53850, et seq. Section 53850 authorizes a city to sell a Temporary Revenue Anticipation Note (TRAN) to raise funds to address general government operations during periods when normal revenues are too low, and then redeem the TRAN during periods when revenues are higher (both the sale of the TRAN and its redemption is to be accomplished within the same fiscal year). Section 53850 does not authorize a city to borrow money from an RDA. Under this note, the city borrowed \$16,863,162 (including the original \$8 million) before it repaid the RDA.

During May 2011, the members of the city council, sitting as members of the RDA board, agreed to a Prepayment and Partial Satisfaction Agreement (PPSA) to repay the September 22, 2010 promissory note. Under the PPSA, this was to be done through two actions:

- On September 1, 2000, the city and the RDA entered into a Reimbursement Agreement to pay for the RDA’s share of costs related to Certificates of Participation (COPs) the city issued to fund costs related to the South Montebello Industrial Redevelopment Project and the Montebello Hills Redevelopment Project. Under the Reimbursement Agreement, the RDA would have made payments to the city totaling \$17,462,276 during the period November 1, 2014, through November 1, 2026. Under the PPSA, the city has agreed that the RDA will not make any payments during this period. Instead, the RDA agreed to consider the present value of these payments as partial payment for the actual amount that was loaned to the city under the September 22, 2010 promissory note. The present value was determined to be \$13,487,438. This leaves a balance of \$3,375,724 (\$16,863,162 actually borrowed less \$13,487,438).
- On June 2, 2011, the city wire-transferred \$3,375,724 to the RDA.

These events raise several concerns about the ability of the RDA members to make decisions that are consistent with the goals of the redevelopment program:

- Under California Health and Safety Code section 33603, an RDA may invest any money that is not required for immediate disbursement, in property or securities in which savings banks may legally invest money subject to their control. The intent of such an investment is to produce additional revenue from interest or other means to increase the level of activities that an RDA can address. Since both promissory notes were non-interest-bearing, it appears that the RDA members who approved them were negligent in carrying out their authority under Health and Safety Code section 33063.
- Both loans have significantly reduced the amount of funds that the RDA has available to carry out the purposes of redevelopment described in California Government Code sections 33030-33039, 33050-33051, and 33070-33071. The agreement to accept the present value of COPs payments instead of actual cash means that recovery of this reduction will not be fully realized for nearly 15 years. Again, it appears that the RDA governing board members were negligent in carrying out their authority to protect the assets of the RDA so the assets can be used for the purposes described in the sections above.

The appointed RDA governing board members also are the elected members of the city council which creates the potential for conflicts of interest. In this instance, it appears that council members, acting as RDA governing board members, entered into these loans and repayment agreements mainly, if not solely, for the benefit of the city. That benefit was to allow the city to use RDA funding for its general operations that would normally have been paid for from the city's General Fund.

The resolutions that authorized the loans indicated the city's ability to keep performing its general operations would benefit the RDA and its programs. However, this conclusion does not appear to support a decision to fund the entire city's General Fund shortfall, for the following reasons:

- There was no information provided about what specific benefits to the RDA would be and how much of the amount loaned would be needed to achieve these benefits.
- As noted in other parts of this report, the city already charges the RDA for specific costs of services it provides to the RDA, including the COPs payments mentioned above.
- The decision-making of the city council members (both during city council meetings and when they sat as RDA governing board members) seemed almost entirely focused on the impact to the city if the RDA funding was not obtained. For instance, Mr. Peter Cosentini, the then-Interim City Administrator, noted at the September 22, 2010 city council meeting that, without the extension of the original loan and the infusion of cash, the city would run out of money to fund its general operations within a few weeks, at best.

Therefore, it appears that the decisions were made without regard for the impact on the RDA and its ability to carry out the purposes of the redevelopment program as outlined in state statutes.

We recommend that the RDA consider the following actions to ensure that the concerns noted above do not reoccur:

- The RDA should develop policies that require decision-making by RDA governing board members to be focused solely on achieving the goals of the redevelopment program as outlined in the Health and Safety Code sections cited above.
- The RDA and the city should develop a plan to repay the outstanding balance of \$13,487,438 in a shorter period of time to ensure that all funding can be made available for RDA-eligible projects as soon as possible.
- The RDA and the city should develop a plan to ensure that the RDA receives equitable interest on the amounts loaned.

EXAMPLE 2—The RDA board approved issuance of more than \$28 million in forgivable loans.

During the course of our review, we became aware of allegations that the RDA may have made a number of loans that were forgiven without any payment and that forgiveness may have been linked to campaign contributions.

In reviewing this issue, the auditors determined that, during the period 1997 to 2001, the city council members sitting as the RDA board members, approved “forgiveness” on seven loans (Appendix 1).

A common type of forgivable loan is a development loan issued by a local government or by lenders participating in a government program. These loans are designed to help improve destitute areas of a city or encourage the local economy. Generally, the borrowers are contractors and/or small businesses. By completing a building project or reaching a certain level of success, the borrower can fulfill the necessary requirements and have the loan forgiven. Governments use these loans to encourage specific community goals.

Loans are referred to as “forgivable loans” because they contain a provision that allows the obligation to pay during each year of the loan to be “forgiven,” or credit to be given if payment was made, provided that the recipient of the loan comply with the conditions specified in the loan. For example, the funding for move-in assistance for Family Ford (Appendix 1) is an incentive to attract and keep the business locally. The \$100,000 loan was given when the dealership moved in provided it made more than \$200,000 in improvements. The loan was to be repaid within five years including interest at 8%. Under the terms of the agreement, the dealership received \$1 credit for every \$100 in sales over \$10 million, up to \$25,000 per annum.

Generally, this type of arrangement is allowable under the California redevelopment statutes. The RDA has not used this type of loan for nearly 10 years. In addition, three of the seven loans were fully “forgiven” or settled under the terms of the agreement.

As the information in Appendix 1 shows, five of the seven loans were made to two different developers: TELACU and the Attina Family members, doing business as Pacific Development Consultants and Montebello Senior Villas, respectively. During the time period these loans were being considered, these two developers made campaign contributions to city council members who, as noted above, also sit as members of the board for the RDA, and in that capacity make decisions on funding, such as these “forgivable” loans. Listed below is a chart of these contributions:

<i>Year</i>	<i>Contributor per CA Form 460</i>	<i>Contribution Amount</i>	<i>Council Member</i>
TELACU:			
2000	TELACU	\$ 2,500	Ed Vasquez
2001	TELACU	3,000	Ed Vasquez
2001	TELACU	3,000	William Molinari
1999	TELACU	2,000	Kathy Salazar
2003	TELACU	2,000	Kathy Salazar
2005	TELACU	5,000	Kathy Salazar
2000	TELACU	2,500	Mary Anne Saucedo
2005	TELACU	2,925	Mary Anne Saucedo
2007	TELACU	5,000	Mary Anne Saucedo
2005	TELACU	<u>2,500</u>	Rosemarie Vasquez
Total		<u>\$ 30,425</u>	

<i>Year</i>	<i>Contributor per CA Form 460</i>	<i>Contribution Amount</i>	<i>Council Member</i>
Attina Family Name and/or Businesses:			
2000	Pacific Development Consultants	\$ 2,000	Ed Vasquez
2000	Montebello Senior Villas	2,000	Ed Vasquez
2001	Peter Attina	1,500	William Molinari
2002	Pacific Development Consultants	2,500	William Molinari
2005	Montebello Senior Villas	3,500	Kathy Salazar
2007	Peter Attina	2,000	Kathy Salazar
2000	Pacific Development Consultants	2,000	Mary Anne Saucedo
2001	Montebello Senior Villas	2,000	Mary Anne Saucedo
2003	Pacific Development Consultants	500	Mary Anne Saucedo
2005	Montebello Senior Villas	750	Mary Anne Saucedo
1995	Henry Attina	<u>2,250</u>	Art Payan
Total		<u>\$ 21,000</u>	

EXAMPLE 3—*Bank accounts were not included in the RDA's financial records.*

One of the services the City of Montebello provides to the RDA in return for reimbursement of costs is establishing and maintaining all financial accounts, including the establishment of bank accounts. The following two examples indicate that these services were insufficient to prevent two instances of RDA bank accounts that were not accounted for in the official financial records of the RDA or disclosed in the RDA financial statements or reports. In fact, RDA staff stated that they were unaware of these bank accounts until early 2011. The elected members of the city council, in both their capacity as members of the city council and as members of the board of the RDA, have an obligation to ensure that services provided to the RDA are both allowable and accurate. In Finding 1 and Finding 2 of this report, we described how the RDA was charged for unallowable expenses by the city. In the information provided below we describe how the accounting services resulted in the loss of control over the two bank accounts.

Union Banc

The funds remaining in this UBIS brokerage account represent the dividends that were received after the RDA transferred all available funds from this account as of October 31, 2000, to Montebello Hillside LLC. These funds were not recorded on the General Ledger.

This UBIS account was opened on October 27, 1999. On November 1, 1999, a wire deposit in the amount of \$963,041 was made to this UBIS account from bond proceeds of the "Montebello Hills Redevelopment Project Tax Allocation Parity Refunding Bonds, 1998 Series A." This amount, along with dividends, remained in this UBIS account until October 31, 2000, at which time the balance was \$1,007,003. On November 1, 2000, two wire transfers totaling \$1,007,003 requested by the RDA were made, effectively reducing the balance in the account to zero. Both wires were sent to Montebello Hillside LLC bank accounts. One was at PPF Bank & Trust and the other was with Wells Fargo Bank.

Subsequent to these transfers, additional dividends were received by this UBIS account and have remained there to this date, along with additional dividends. Even though the RDA has been receiving monthly statements for this UBIS account, the dividends that were received were not recorded on the General Ledger.

The balance of approximately \$5,500 in this UBIS account has since been recorded on the General Ledger of the RDA.

Banco Popular Savings Account

The RDA administered a Revolving Loan Fund Program established in 1992 and ended in 1996, as part of its business retention and attraction efforts. The RDA provided up to 33% of the loan amount and Banco Popular (successor to Commerce National Bank) provided the remaining funds. In all, approximately eight loans were issued to various local businesses and organizations pursuant to this loan program. The current balance of approximately \$240,000 was not recorded on the RDA's General Ledger.

According to the RDA's and the city's personnel, the balance represents repayment from the Montebello Elks (MELCA) for the last outstanding loan in November 2007, plus accrued interest. The account has been dormant since then. No specific accounting was available for our review for transactions that went through this savings account.

RDA and city staff members still are researching the details of all of the transactions and why this account was not included in the RDA's General Ledger. In addition, they also are working with Banco Popular to ensure that all amounts due the RDA or the city on the loans, have been paid and deposited into this account. The balance of approximately \$240,000 in this Banco Popular account has since been recorded on the General Ledger of the RDA.

City's Response

This section of the SCO draft report discusses situations which the State Controller apparently feels need to be presented, which the City believes only serves to raise unsubstantiated or already addressed concerns regarding the management of the Agency. The inclusion of these observations are not pertinent to the audit and pushes the State Controller's review into the political realm which is not appropriate or proper and they should be removed from the draft report.

The observations are not relevant as discussed below:

- Example 1: California Health & Safety Code Section 33200 provides specifically that the legislative body, the City Council for a City, may serve as the governing board of the Redevelopment Agency. The Montebello City Council serves as the Redevelopment Agency Board as provided for under this section of state law. The vast majority of local redevelopment agencies in cities have the City Council serving as the Redevelopment Agency Board.

In regard to the 2010 TRAN between the City and Redevelopment Agency, the subject TRAN was repaid prior to June 30, 2011, and recently the Los Angeles Superior Court dismissed a legal challenge to the TRAN brought by a third party and in dismissing the action validated the transaction.

- Example 2: The State Controller identifies that "forgivable" loans are "... allowable under the California redevelopment statutes." Forgivable loans are considered a "best practice" for redevelopment agencies and are generally linked to a level of performance providing for a bargained level of public benefit or consideration such as affordability covenants for a period of years or the generation of a specific program of development and the generation of public revenues. The forgivable loans in Montebello were approved during public noticed meetings with supporting documentation provided at the time of approval by the Agency Board. In addition, Montebello City Council members, who sat as Redevelopment Agency Board members when the forgivable loans were approved, disclosed campaign contributions as required by State Law on the required Form 460 which are available for public review and inspection. As such, disclosure was made pursuant to State Law and campaign contributions do not require recusal under State law as they do not give rise to a conflict of interest as a matter of law.
- Example 3: The two special purpose accounts addressed in this observation were exhaustively reviewed and researched by the City and comprehensive report was provided to the City Council on August 10, 2011. This final report was provided to the State Controller's Office at that time.

The SCO should eliminate these observations.

Exhibits:

- A. Gas Tax Fund Illustrative Cash Flow
- B. Golf Course Fund Gas Tax Eligible Expenditures
- C. 1992 Cost Allocation Study
- D. 2010 Willdan Cost Allocation Model
- E. Cost Allocation Analysis
- F. Dodger Tickets General Ledger Documentation
- G. City Travel Policy
- H. Don Parker Excess/Surplus Calculation
- I. 2917 Via Campo Resolutions
- J. April 27, 2011, City Council Agenda
- K. Eadie & Payne Presentation on Audit from April 27, 2011
- L. 2010/11 Final Annual Budget
- M. 2011/12 Adopted Annual Budget
- N. Eadie & Payne Response

SCO's Comment

The city requested the SCO to remove these observations as well the some findings discussed in the Findings and Recommendations section. The SCO believes that these observations are necessary and appropriate as they provide additional transparency and accountability about the RDA's fiscal practices.

Appendix 1— Forgivable Loans

<i>Project</i>	<i>Type of Project</i>	<i>Funding Source</i>	<i>Date</i>	<i>Total Amount</i>	<i>Annual Amount</i>	<i>Condition</i>	<i>Status</i>
Family Ford	Move-in assistance	Tax increment	1997	\$ 100,000	\$ 120,000	\$1 credit for every \$100 over sales of \$10 million	Closed
Whittier Boulevard Senior Villas	160 low-income senior apartments	20% housing set-aside funds	07/01/1997	\$ 11,000,000	\$ 111,111	Low/Mod income affordability covenants	Open
Villa Campo Senior Villas	75 low-income senior apartments	Tax increment	04/05/1999	\$ 6,000,000	\$ 60,606	Low/Mod income affordability covenants	Open
Applebee's	New business attraction	Tax increment	08/17/1999	\$ 1,068,000	\$ 10,788	Restaurant construction	Open
Ostrom Chevrolet	New car dealership	Tax increment	10/19/1999	\$ 2,000,000	\$ 200,000	Economic activity, revitalization, business retention, generation of substantial sales tax	Closed
Garfield Financial Corporation *	20 low- to moderate-income single-family homes	20% housing set-aside funds	03/21/2000	\$ 1,574,000	1/20 th or \$18,000 as housing units sell	Low/Mod income affordability covenants	Entered into settlement agreement
Montebello Downtown Plaza	52 senior apartments; 27,000 square feet retail	20% housing set-aside and home funds	12/21/2001	\$ 6,500,000	\$ 65,657	Low/Mod income affordability covenants	Open

* The loan was not forgiven because the developer only developed market-rate homes. Subsequently, the developer entered into a settlement agreement (No. 2263) with the RDA to repay the \$1,574,000.

Attachment— City's Response to Draft Report

That portion of the city's response that relates to the
Montebello Gas Tax Fund is not included here.



City of Montebello

September 8, 2011

Mr. Jeffrey V. Brownfield
Chief, Audit Division
California State Controller's Office
PO Box 942850
Sacramento, CA 94250-5874

Dear Mr. Brownfield:

The City of Montebello received the draft State Controller reports for Redevelopment and Gas Tax dated August 24, 2011, via certified mail on Monday, August 28, 2011. Per our discussion, our response is due on September 8, 2011, and is here with transmitted.

First, I would like to thank the staff of the State Controller's Office for their professionalism and commitment to identifying issues which may need to be addressed here in Montebello. The City has been in a period of significant financial strain and we have welcomed the assistance and advice of your staff as we address a multiplicity of issues.

As you are aware, a new Interim City Administration team was specifically selected to guide the City through its current financial difficulties and started on May 12, 2011. Since that time, a number of steps have been taken to address the City's financial difficulties. On June 22, 2011, the City Council adopted a balanced budget for FY 2011/12 which provides for a reserve of \$1 million ending a multi-year period of deficit spending. In addition, the City Council adopted a Statement of Financial Goal, Principles, and Guidelines at that same (Attachment 1), which will guide our future financial management including grants funds. As a third action on that evening, the City Council approved a General Fund Financial Recovery Plan, which has been subsequently updated (Attachment 2). All of these actions set the stage for a Tax and Revenue Anticipation Note sale by mid-September to bridge the normal timing issues associated with matching expenditures to revenues within the single fiscal year.

We also want to assure the State Controller's Office that the City is not in risk of insolvency or of having to pursue bankruptcy as an option to address its current financial difficulties. Any prior press reports or other statements to that end were grossly exaggerated in our opinions. Certainly, the most recent actions taken by the City Council as articulated in this letter have further reinforced that the City's difficulties can be addressed. It is our understanding that many of the State Controller's concerns were

based upon the possibility of insolvency or bankruptcy and other inaccurate media reports, and as such this should not be a basis for any of your findings or concerns. A letter recently authored by Mayor Barajas and approved by the City Council which addresses this is attached (Attachment 3).

While we appreciate the effort the State Controller's Office dedicated to this review, elements of the Introduction on pages 1 and 2 of the Redevelopment Review Report beginning with the reference to "recent presentations to the City Council," are completely inappropriate to include as they are nothing but a collection of hearsay or selected perspectives of those who seek to perpetuate or misrepresent the City's financial situation. In fact, the mere inclusion of these items at a time when the City is trying to stabilize its operations and move forward in a responsible and financially prudent manner is detrimental to our shared goal of putting the City and its Redevelopment Agency on firm financial footings. The incorporation of this type of commentary seems to be of a political nature and to be inappropriate for inclusion in an audit. The Management Discussion prepared for the City's proposed 2011 Tax Revenue Anticipation Note is the City's summary of what occurred and what is being done to address any issues (Attachment 2).

The City's detailed responses to the findings and observations in your draft reports are attached (Attachment 4). We would appreciate having findings which are in error removed rather than having them cited followed by our response stating that they are in error. To leave them in imparts to an uninformed reader that noncompliance exists when it does not. Additionally, where corrective action was taken that should be cited in the finding and not just in the response as it imparts to the reader that corrective action has not been taken.

The Gas Tax draft report identifies three (3) findings for the 09/10 Fiscal Year which is the single year reviewed. The City disagrees with the two (2) of the findings and they have been addressed in the attached response which includes documentation in support of our position. In regard to Finding 2, the City acknowledges the concern raised but had addressed that item prior to the State Controller's review.

The Redevelopment draft report has fifteen (15) findings and three (3) observations for the 5 year period ending June 30, 1010, which was reviewed. Of these findings, nine (9) are what are considered "compliance" findings and relate to missed or late reports and these are items which require correction in the future or they have already been corrected by recent actions (Findings 7, 8, 9, 10, 11, 12, 13, 14, and 15) as elaborated in our response.

The City substantially disagrees with the remaining six (6) findings (Findings 1, 2, 3, 4, 5, and 6) as articulated in our response with the exception of that the portion of the annual sales tax auditing and analysis services related to auditing identified in Finding 1 should not be an expense of the Redevelopment Agency. The City believes that based on additional information provided and/or clarified that the State Controllers findings are unsupported and the State Controller should eliminate these findings.

The three (3) observations contained in the SCO RDA draft report were issues the Controller wished to address which did not raise to a level to allow them to be findings. In regard to the observations, it is clear the SCO is using or implying a standard which exists above any legal or regulatory requirements and if these are issues in Montebello, they are issues in public agencies across the State, including the State of California itself. Our response on these matters addresses the three observations from this and other relative perspectives and the observations should be eliminated from the State Controller's draft report as they are editorializing in nature and take the draft report into a purely political realm.

While we have prepared a comprehensive response to the SCO reports specific to Montebello and the issues raised, the City also reviewed the draft report and the concerns of the SCO in the context of other Redevelopment Agencies which the Controller has reviewed. The State Controller undertook a review of 18 redevelopment agencies across the State earlier this year. We see that many of the issues identified or raised in that 18 agency review are also reflected in the Montebello RDA draft report. Clearly, since that 18 agency report results in recommendations for legislative and regulatory reform, the issues identified in Montebello are also mostly beyond any existing current statutory or regulatory frameworks. We believe that the State Controller's Office should cite noncompliance with existing law but should refrain from imposing its interpretation of law as a basis of noncompliance. The interpretation of the law should be left to the courts. Legal experts and others versed in redevelopment operations may have different interpretations and, without specific guidance from the courts, those are equally as valid as those of the State Controller's Office.

The City of Montebello and its Redevelopment Agency are committed to meeting all existing statutory and regulatory requirements as they now exist or as they may exist in the future, if modified, and this is reflected on our response. The new City Management team has been moving forward expeditiously to address the City's financial difficulties and we are using the information and review by the State Controller as part of our overall approach to ensuring a successful financial future.

We look forward to the receipt of your final report reflecting the information we have provided in our response.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Larry Kosmont".

Larry Kosmont
Interim City Administrator

Attachments:

- 1) Statement of Financial Goal, Principles and Guidelines
- 2) Management Discussion and General Fund Financial Recovery Plan
- 3) Mayor Barajas letter
- 4) City Response and Exhibits

cc: David C. Biggs, Interim Assistant City Administrator
Arnold Alvarez-Glasman, City Attorney
Michael Huntley, Director of Planning & Community Development
Norma Salinas, Director of Municipal Services
Francesca Schuyler, Director of Finance
Eden Casareno, Eadie and Payne
Don Parker, Redevelopment Reporting Solutions
Ethan Walsh, Best, Best & Krieger

Redevelopment Agency

Finding 1

- Ineligible Administrative Costs

The City believes that the level of administrative overhead charges to its various funds, including Redevelopment, is supported and well within an acceptable range based on any number of cost recovery models. For redevelopment, there is no statutory or other regulatory requirements as to how administration and overhead costs are to be allocated, and absent such requirements, the determination of the Governing Board of the Agency as to appropriateness is made through the adoption of the annual budget, at the Board's sole discretion.

Additionally, it should be acknowledged, that there are no statutory or regulatory requirements to guide redevelopment agencies statewide as to the appropriate methodology or guidelines for calculating the administrative costs allocated to a redevelopment agency. This is apparent in the State Controller's report of 18 redevelopment agencies from July 1, 2009 through June 30, 2010 where a finding was made stating that there are significant differences among redevelopment agencies for accounting for planning and general administrative costs.

That being said, the City is aware that its current cost allocation study, last updated in 1992, is outdated and it is in the process of being updated (apparently the SCO's audit team was not provided with a copy of the 1992 study, and as one has been subsequently located, a copy is attached as Exhibit C).

The City embarked on an effort to update its cost allocation model in 2010 and retained the firm of Willdan Financial Services to undertake this effort. Willdan is an acknowledged leader in this area. Willdan completed a Cost Allocation Plan for the City in October, 2010, with the City's intent at that time having been to review and implement the model for purposes of undertaking administration allocations for FY 2011/12. However, the City's burgeoning financial crisis and staff turnover resulted in this effort being delayed. The prior year's level of overhead and administration allocations were carried over to FY 2011/12. A copy of the proposed Willdan Cost Allocation Plan, not yet accepted by the City, is attached as Exhibit D for background information.

The new City management team has on a priority basis, renewed the review of the Willdan Cost Allocation Plan in order to make adjustments to the methodology proposed by Willdan. Adjustments may include capital projects, investment management, and self-insurance contribution review, to ensure a more comprehensive level of cost recovery. The City is on track to have the updated model in place for FY 2012/13.

In the interim and in order to respond directly to the concerns expressed by the State Controller's Office, the City did undertake an effort to test the historical allocations reviewed by the State Controller against the proposed Willdan Cost Allocation Plan. In this exercise, the City made preliminary adjustments to the Willdan Model to reflect all costs and a full allocation of administration departments to reflect total costs for application to redevelopment. The Willdan initial allocation and an adjusted calculation were determined and the percentage for the redevelopment funds for that control year of 2009/10 (both budgeted and actual expenditures), was applied to the prior fiscal years to allow for an indication of scale comparison. A five-year average was also illustrated for purposes of comparison.

Finally, two other measures were developed, one based on administrative allocations as percentage of revenue and one as a percentage of expenditures. This analysis is attached as Exhibit E and clearly demonstrates that administration costs allocated to redevelopment were supportable notwithstanding the lack of a regularly updated cost allocation model.

Based on the lack of statutory authority and the additional supporting documentation provided, the SCO should eliminate this finding.

- **Ineligible Goods & Services**

The State Controller's Office would be correct if the services were purely for evaluating and ensuring that sales tax was appropriately reported and paid to the City. However, the HdL contract has two components – sales tax reporting and sales tax auditing. Sales tax reporting is of greatest value to the Redevelopment Agency since not only are most of the City's retail sales tax producing businesses located in redevelopment project areas, but those businesses and commercial centers generate the highest sales tax such as the Shops at Montebello, Montebello Town Square, Montebello Plaza, Costco and the Chevron gas distribution facility. In addition, sales tax levels are a key indicator of economic health, and sales tax data is one of the key performance indicators for redevelopment activities as well as return on investment metrics for specific redevelopment projects. Accordingly, payment by the Redevelopment Agency for sales tax reporting services by HdL is completely appropriate and necessary. The City will undertake a further review of the amounts paid to HdL for any sales tax auditing costs and these will be reallocated to the City's General Fund.

The SCO should eliminate this finding as to sales tax reporting services.

- **Ineligible Promotional Items**

The State Controller's Office would be correct if the intended purpose was to promote the City apart from its redevelopment and economic development components. These promotional items are acquired specifically for the purpose of promoting the City as a place for redevelopment and investment.

The majority of the City's retail areas are located in redevelopment project areas and all of the promotional items identified in the draft finding were purchased specifically for the Redevelopment Agency's retail recruitment and attraction efforts at the International Council of Shopping Centers conference in Las Vegas. The ICSC Conference is the primary outlet for cities to exhibit various retail investment opportunities, which such opportunities are not competitive unless promoted in conjunction with the prospect of redevelopment financing support, particularly in urban areas in California such as Montebello, wherein absent redevelopment funding assistance, land values exceed pro forma pricing benchmarks for most retailers and restaurants.

Since this is a national conference, it is important to identify where Montebello is located since many of the attendees are from all over the United States. Attendees are more likely to identify with the name of the City than the Redevelopment Agency. By the State auditors deciding that because the City's name and Economic Development Division's phone number (whose staff members are Redevelopment Agency staff) are the only information identified on the promotional items does not promote redevelopment is insufficient to make a determination of its validity. The national event that the promotional items were purchased for is fully staffed by Redevelopment staff and Agency members promoting opportunities. Understanding the location of the City is one of the keys to success. Further, efforts to recruit private investment at this conference are enhanced significantly due to the tools provided by the redevelopment agency within the project areas. Redevelopment financing is a significant basis for the multiple economic development based meetings at this and other conferences that the Staff attends.

The SCO should eliminate this finding.

- **Ineligible Expenditures related to Independent Cities Association**

The State Controller's Office would be correct if the intended purpose of the Independent Cities Association and conferences was to promote general City tourism. However, the ICA is an association of cities which provide a full range of services including police and fire services. The topics covered at their meetings often include redevelopment, economic development and general governance issues such as AB 1234 and managing elements of any public entities, including evaluating positions such as the City Administrator/Redevelopment Executive Director. As such, membership and participation in ICA provide direct benefit to the Redevelopment Agency and those Redevelopment Agency Board members who participate and use of redevelopment funds in support of this is appropriate. Historically, only half of the costs to attend these events have been charged to the Redevelopment Agency with the balance being paid from the City's General Fund.

The SCO's one cited example of where the Redevelopment Agency paid 100% of a single expense as part of an ICA event was in fact fully refunded since the Council Member/Agency Board Member who was to attend had cancelled. If the Council Member/Agency Board Member had attended, it is likely the final reconciliation of the total expenses for the event would have been reconciled and the normal 50%/50% allocation would have been applied.

The SCO should eliminate this finding.

- **Ineligible City Administrator Expenses**

The State Controller's Office is mistaken in their assertion that expenses for the City Employee's Day at the Dodgers were charged to the Redevelopment Agency as they were charged to the City's General Fund and supporting documentation is provided as Exhibit F. Also important to note is that a majority of the costs associated with Dodger's Day was reimbursed by employees. Expenses related to a dinner in Las Vegas was a legitimate business expense and appropriately charged to the Redevelopment Agency given the singular purpose for the trip was to promote retail attraction and recruitment with the most significant retail areas in the City located in redevelopment project areas. The City's adopted travel policy provides for a per diem, or average anticipated level of daily expense, based on an array of travel costs including meals, dry cleaning and other incidentals, which an employee may occur while travelling on business. There is no requirement under the City's travel policy, copy attached as Exhibit G, that a per diem be offset in those instances where a meal might be reimbursed directly, just as there is no requirement for the City to reimburse an employee in those instances when a per diem does not cover actual expenses. Petty cash reimbursements for lunches were appropriately documented and only 50% of these lunches were charged to redevelopment. The purpose of these lunches was for the City Administrator/Redevelopment Agency Executive Director to review upcoming items on the City Council/ Redevelopment Agency agenda. Redevelopment Agency items tend to be more complicated and take up a considerable portion of the overall time devoted to City business in Council meetings. To the extent that the State Controller's Office was concerned that some of these reimbursements were self-approved by the City Administrator/Executive Director, the City will ensure that all future reimbursements requests by the City Administrator/Executive Director are approved by the City's Director of Finance; however, such a concern is purely perception on the SCO's part and does not change the character of the expenses.

THE SCO should eliminate this finding.

Finding 2

The State Controller's Office is correct in that amending the redevelopment plans for two project areas to eliminate the limit on the establishment of debt would establish pass through obligations. However, while the Health and Safety Code does place this obligation on the Agency, it does not specify when the payments to the taxing entities are to be made.

It is possible that due to cash flow considerations an agency would be unable to make its required payments, especially in light of State raids on redevelopment coffers in recent years. Therefore, failure to make the required payments should not be a finding. While that is unfortunate for the cash flow of the State, the legislature has had numerous opportunities to establish a fixed payment date but has never done so. The Redevelopment Agency will make the FY 2011/12 pass through payments and will develop a payment schedule for the prior two years as part of its implementation of AB1 27X and has evaluated the impact on its cash flow.

The SCO should eliminate this finding.

Finding 3

The Agency acknowledges that it has a deferral in its Low and Moderate Income Housing fund with an Agency Board approved repayment plan and the State Controller's Office does not indicate that it is not valid. Therefore, quoting Section 33334.6 (g) and citing the repayment years is inappropriate since non-compliance in establishing the deferral or its repayment is simply not present. The SCO commentary gives an uninformed reader the impression that something is wrong when it is not and should be removed. Since the Health and Safety Code does not specify the type of repayment plan or its specific provisions including any requirement for interest to be paid, the comment of the SCO restating the years and amounts to provide for interest due appear to be provided only for editorial reasons and should be eliminated as it imparts noncompliance to an uninformed reader. In 2002, the Redevelopment Agency adopted a repayment plan, which was updated in 2009, for repayment of the deferral without interest. The Agency Board's determination is all that is required under the Health and Safety Code.

It appears that the State Controller is indicating that this valid deferral "was not recorded on the RDA's general ledgers" and that has resulted in the difference noted in total assets and fund equity. However, nowhere in this finding has the State Controller's Office indicated that there is a requirement in the Generally Accepted Accounting Principle (GAAP) to record, in an agency's financial records, such a deferral. This approach to recording deferrals was considered by an authoritative committee of the California Society of Certified Public Accountants many years ago; but since, the process to record a deferral would artificially inflate fund equity, for assets which are not currently available, and a requirement to record a deferral was not instituted. Instead, it was left at the discretion of the agency and its auditors.

The Controller's citation of 33334.2(j)(1)(C) of the Health and Safety Code relating to interest potentially due the Housing Fund is correct as far as it goes; however, that is not a complete quotation of that section and is not applicable to a valid deferral. The prior two subsections (A) and (B) begin with "An action to compel compliance with the requirement of this section..." The remainder of that section which was not quoted by the State Controller is "...shall repay the funds with interest in one lump sum pursuant to Section 970.4 or 970.5 of the Government Code or may do either of the following:

- i. Petition the court under Section 970.6 for repayment in installments.
- ii. Repay the portion of the judgment due to the Low and Moderate Income Housing Fund in equal installments over a period of five years following the judgment."

In looking at the complete section, we see terminology "action to compel," "petition the court," and "judgment" which gives the impression that this section relates to actions by courts to compel compliance for non-payment and not an additional requirement established for a valid deferral of the Housing Set-Aside.

In addition, the deferral of the 20% housing set-aside in the early years of the redevelopment project area allowed these funds to be invested into the redevelopment program in the Montebello Hills Redevelopment Project area. Throughout the 1990's there was major commercial investment in the Montebello Hills Redevelopment Project area which resulted in the development of the Montebello Town Square a sub-regional shopping center, the Costco store and the fourth major anchor department store (Macy's) at the Shops at Montebello a regional indoor shopping center. This deferral effectively jump started the redevelopment effort with a resultant increase in tax increment revenues at a level which would not have occurred without the deferral. As such, the Low and Moderate Housing Fund is now benefitting from significant annual contributions from this project area which would not have occurred without the deferral.

The SCO should eliminate this finding.

Finding 4

Section 3334.12(a)(2) which was cited by the State Controller's Office gives agencies three years to either expend or encumber amounts determined to be Excess/Surplus before sanctions would apply not two years as indicated in the finding. Additionally, no disclosure would be required until three years has expired; as such sanctions are not applicable against an agency.

As to the amount cited for the potential Excess/Surplus, it was stated at \$12,219,124 with no supporting computation provided. At the request of the Agency, the State Controller's Office provided this computation. The Agency had this reviewed independently by Mr. Donald L. Parker, CPA, of Redevelopment Reporting Solutions, the foremost expert in the State on redevelopment reporting. Mr. Parker prepared an independent calculation which is attached as Exhibit H to this response. In this calculation he utilized the State Controller's computed balance for the Low and Moderate Income Housing Fund for illustrative purposes only which shows the largest possible balance for the fund; however, as discussed previously that amount is not correct as recordation of the deferral is not required by GAAP. Even with this distorted amount, as of July 1, 2009, no Excess/Surplus exists for the Agency. The same conclusion was reached by the Agency's independent auditor in the Agency's 2009/10 audit.

Mr. Parker's computation differs from the State Controller's Office because the SCO did not remove unavailable amounts and amounts exempted by the Health and Safety Code from the amount subject to limitation. As to removing unavailable amounts, the deferral discussed under Finding 3 was added by the State Controller's Office in the amount of \$12,139,385. Since this amount is unavailable presently, covered by a long-term valid repayment plan to the Low and Moderate Housing Fund, it should not be part of the amount subject to the Code limitations. The only established approach and format for calculating Low and Moderate Income Housing Excess/Surplus has been the format and approach established by the State Department of Housing and Community Development (HCD) in their reporting forms.

Since the HCD approach is one of subjecting only available resources to the prescribed limitation of the Code that approach should be followed by the State Controller's Office. As to specifically exempted amounts, the State Controller's Office did not exempt amounts present in the Senior Housing Capital Project Fund. These funds represent remaining debt proceeds relating to a senior housing project. Utilizing that determination, under Section 3334.12 (g)(3)(B) of the Code, debt proceeds are specifically exempted from the calculation of Excess/Surplus.

The SCO should eliminate this finding.

Finding 5

See the discussion under Finding 1 – Ineligible Administrative Costs. The City's administrative allocation to the Low and Moderate Income Housing Fund can be supported and will be further refined during the update the City's Cost Allocation Model.

The SCO should eliminate this finding.

Finding 6

These charges made to the Low and Moderate Income Housing Fund appear to have been an administrative error. The \$9,423 should have been charged to funds available with the Bond Trustee and the City will make the correction and will deposit the refund of the amounts charged to the Moderate Housing Fund once received from the Bond Trustee.

The City will correct the administrative error.

Finding 7

At the time the subject property was acquired, the City agrees that the required resolutions with findings were not adopted. On August 24, 2011, the City and Redevelopment Agency adopted the required resolutions and copies attached as Exhibit I.

The City has already corrected this matter.

Finding 8

The City acknowledges the annual audit for 2009/10 was not submitted in a timely manner due to the specific circumstances of that fiscal year.

The City will establish the appropriate internal controls to ensure that future audits are submitted as soon as completed.

Finding 9

As the Code only requires presentation and does not specify any action by the Legislative Body, documentation of this review may not have been available. The 2009/10 Redevelopment Agency audit was reviewed with the Legislative Body on April 27, 2011, as part of the a presentation of all 2009/10 audits (General Fund, Redevelopment Agency, Transit Fund, and Single Audit) by the independent auditor Eadie & Payne. The minutes for this meeting have not yet been prepared or approved, but they will reflect that the Redevelopment Audit was reviewed with the City Council. In the meantime, a copy of the Council Agenda for that date which lists the Annual Audit review under Agenda item 18 is attached (Exhibit J) as id the Eadie & Payne Presentation from April 27, 2011 (Exhibit K).

The City will establish the appropriate internal controls to ensure that Redevelopment Agency Annual Audit is submitted to the legislative body in a timely manner in the future and are appropriately reflected in the agenda and minutes.

Finding 10

The City believes that the components required to be in an Annual Report to the Legislative Body have been provided each year though not in a single report labeled as such.

The City will establish the appropriate internal controls to ensure the development and timely present an Annual Report to the Legislative Body in future years.

Finding 11

The City acknowledges that elements of required information were not included in the adopted budgets. The final budget for 2010/11 was adopted on June 15, 2011, and included the required information. The FY 2011/12 Budget adopted on June 22, 2011, included the required information. Both documents are available on-line and are attached as Exhibits L and M.

The City will establish the appropriate internal controls to ensure that all required information is included in the Annual Budget adopted in future years.

Finding 12

The City acknowledges that the Five Year Implementation Plan was approved late.

The City will establish the appropriate internal controls to ensure more timely approval of the Five Year Implementation Plan in future years.

Finding 13

The City acknowledges that the mid-plan review did not occur in a timely manner.

The City will establish the appropriate internal controls to ensure that the mid-plan review of the Five Year Implementation Plan adopted on December 31, 2010, occurs sometime between July 1, 2013, and December 31, 2013, and in a timely manner thereafter.

Finding 14

The City acknowledges that a published database of Low and Moderate Income Housing has not been established and maintained.

The City will accumulate the required information regarding existing, new and substantially rehabilitated housing units, into a single published data base before June 30, 2012. The Economic Development Division is preparing a Request for Proposal to select a competent consultant to create an effective database.

Finding 15

This finding relates to situations or information which the State Controller's Office believes should have been cited in the outside audits performed by the Certified Public Accounts serving as the Agency's independent auditors.

While the Agency engaged these auditors to perform the financial and compliance audit, the Agency is only responsible for its actions, and should not be responsible for the decisions of the independent auditors as to what to include or not include in their reports. The City has provided the information in this section to the independent Auditor and their response is attached as Exhibit N. In any event, the comments of the State Controller's Office here relating to procedures of the independent auditors are beyond the control of Agency and are in error.

The SCO should eliminate this finding.

Observations

This section of the SCO draft report discusses situations which the State Controller apparently feels need to be presented, which the City believes only serves to raise unsubstantiated or already addressed concerns regarding the management of the Agency. The inclusion of these observations are not pertinent to the audit and pushes the State Controller's review into the political realm which is not appropriate or proper and they should be removed from the draft report.

The observations are not relevant as discussed below:

- Example 1: California Health & Safety Code Section 33200 provides specifically that the legislative body, the City Council for a City, may serve as the governing board of the Redevelopment Agency. The Montebello City Council serves as the Redevelopment Agency Board as provided for under this section of state law. The vast majority of local redevelopment agencies in cities have the City Council serving as the Redevelopment Agency Board.

In regard to the 2010 TRAN between the City and Redevelopment Agency, the subject TRAN was repaid prior to June 30, 2011, and recently the Los Angeles Superior Court dismissed a legal challenge to the TRAN brought by a third party and in dismissing the action validated the transaction.

- Example 2: The State Controller identifies that "forgivable" loans are "... allowable under the California redevelopment statutes." Forgivable loans are considered a "best practice" for redevelopment agencies and are generally linked to a level of performance providing for a bargained level of public benefit or consideration such as affordability covenants for a period of years or the generation of a specific program of development and the generation of public revenues. The forgivable loans in Montebello were approved during public noticed meetings with supporting documentation provided at the time of approval by the Agency Board. In addition, Montebello City Council members, who sat as Redevelopment Agency Board members when the forgivable loans were approved, disclosed campaign contributions as required by State Law on the required Form 460 which are available for public review and inspection. As such, disclosure was made pursuant to State Law and campaign contributions do not require recusal under State law as they do not give rise to a conflict of interest as a matter of law.

- Example 3: The two special purpose accounts addressed in this observation were exhaustively reviewed and researched by the City and comprehensive report was provided to the City Council on August 10, 2011. This final report was provided to the State Controller's Office at that time.

The SCO should eliminate these observations.

Exhibits:

- A. Gas Tax Fund Illustrative Cash Flow
- B. Golf Course Fund Gas Tax Eligible Expenditures
- C. 1992 Cost Allocation Study
- D. 2010 Willdan Cost Allocation Model
- E. Cost Allocation Analysis
- F. Dodger Tickets General Ledger Documentation
- G. City Travel Policy
- H. Don Parker Excess/Surplus Calculation
- I. 2917 Via Campo Resolutions
- J. April 27, 2011, City Council Agenda
- K. Eadie & Payne Presentation on Audit from April 27, 2011
- L. 2010/11 Final Annual Budget
- M. 2011/12 Adopted Annual Budget
- N. Eadie & Payne Response

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>